

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WASHINGTON

In re:

LLS AMERICA, LLC,

Debtor.

NO: CV-12-486-RMP

Bankruptcy No: 09-06194-PCW

Adversary No: 11-80035-PCW

BRUCE P. KRIEGMAN, solely in his
capacity as court-appointed Chapter 11
Trustee for LLS America LLC,

Plaintiff,

vs.

FRASER MILNER CASGRAIN, LLP,

Defendant.

ORDER GRANTING IN PART AND
DENYING IN PART
DEFENDANTS' MOTION TO
WITHDRAW REFERENCE

This matter comes before the Court on a motion for withdrawal of reference,
ECF No. 1. The Court has reviewed the motions, the responses, other relevant
filings, and is fully informed.

ORDER GRANTING IN PART AND DENYING IN PART DEFENDANTS'
MOTION TO WITHDRAW REFERENCE ~ 1

BACKGROUND

This motion arises from adversarial proceedings that began in the Chapter 11 bankruptcy of LLS America, LLC (“LLS”). According to the adversary complaint, LLS allegedly engaged in a “Ponzi” scheme by accepting loans from various parties and using later loans to repay with interest the earlier lenders. The defendants named in the complaint are all alleged to have lent money to LLS and received a return with interest of their funds. The complaint asserts that the payments made by LLS to the lender-defendants constituted fraudulent transfers and that such transfers should be avoided and returned to the bankruptcy estate to be distributed through the bankruptcy process. The court-appointed trustee seeks the withdrawal of this Court’s automatic referral of this case to the bankruptcy court of this district. The basis for withdrawal is born out of the Court’s granting of withdrawal motions filed by defendants in other adversary actions. In light of the uncertainty surrounding the bankruptcy court’s jurisdiction, the trustee asserts that this Court should withdraw reference as to the trial and allow the bankruptcy court to proceed on pretrial matters. The Defendants have not opposed the motion.

APPLICABLE LAW

Statutory Framework

District courts have jurisdiction over matters that arise under title 11. 28 U.S.C. § 1334. However, district courts “may provide that any or all cases under

1 title 11 and any or all proceedings arising under title 11 or arising in or related to a
2 case under title 11 shall be referred to the bankruptcy judges for the district.” 28
3 U.S.C. § 157(a). After referral, the district court retains discretion to withdraw the
4 reference, in whole or in part, for cause shown. 28 U.S.C. § 157(d). In
5 determining whether to withdraw reference, “a district court should consider the
6 efficient use of judicial resources, delay and costs to the parties, uniformity of
7 bankruptcy administration, the prevention of forum shopping, and other related
8 factors.” *Sec. Farms v. Int’l Bhd. of Teamsters, Chauffers, Warehousemen &*
9 *Helpers*, 124 F.3d 999, 1008 (9th Cir. 1999).

10 A bankruptcy court’s statutory authority to enter judgment in a particular
11 proceeding depends on whether that proceeding is a “core proceeding[]” under §
12 157. § 157(b)(1). A bankruptcy court is authorized by statute to “hear and
13 determine all cases under title 11 and all core proceedings arising under title 11, or
14 arising in a case under title 11 . . . and may enter appropriate orders and
15 judgments” subject to appellate review by the district court. *Id.* § 157(b)(1). A
16 bankruptcy court is authorized to hear a non-core proceeding “that is otherwise
17 related to a case under title 11” but may not enter final judgment on such a matter
18 absent consent of all the parties. § 157(c). Instead, in a non-core proceeding, the
19 “bankruptcy judge shall submit proposed findings of fact and conclusions of law to
20 the district court, and any final order or judgment shall be entered by the district

1 judge after considering the bankruptcy judge's proposed findings and conclusions
2 and after reviewing de novo those matters to which any party has timely and
3 specifically objected." § 157(c)(1).

4 **Impact of *Stern v. Marshall***

5 In *Stern v. Marshall*, the Supreme Court was faced with two questions: (1)
6 whether a counterclaim for intentional interference with a gift by a debtor in a
7 bankruptcy proceeding was a "core" proceeding under § 157; and (2) if so, whether
8 conferring authority to enter final judgment on such a counterclaim was
9 constitutional. *Stern*, 131 S. Ct. at 2600. The Court concluded that the
10 counterclaim at issue was a core proceeding under § 157(b) but that the bankruptcy
11 court lacked constitutional authority to enter final judgment on the counterclaim.
12 *Id.* at 2601.

13 In concluding that bankruptcy courts lacked the constitutional authority to
14 enter final judgment on the counterclaim, the Court relied on the fact that the
15 judicial power of the United States is vested in the Supreme Court and those
16 inferior courts established by Congress pursuant to Article III of the Constitution
17 of the United States. *Id.* at 2608. The Constitution guarantees that Article III
18 judges "shall hold their Offices during good Behaviour" and that an Article III
19 judge's salary may not be decreased during his or her tenure. *Id.* (quoting U.S.
20 Const. Art. III, § 1). Such protections exist to ensure that the judiciary is

1 independent of the executive and legislative branches. *Id.* at 2609. Bankruptcy
2 judges do not enjoy lifetime tenure or a guarantee that their salaries will not be
3 decreased. Accordingly, if a bankruptcy court were to be assigned a matter
4 traditionally within the judicial power of an Article III court, it would circumvent
5 the protections provided by Article III to ensure that parties have access to an
6 independent judiciary. *Id.* The Court in *Stern* held that the counterclaim for
7 intentional interference with a gift was the type of claim that fell within the judicial
8 power granted to Article III courts, and, consequently, it could not be resolved by
9 the bankruptcy court. *Id.* at 2620.

10 DISCUSSION

11 The parties agree that the fraudulent conveyance actions at issue in this case
12 are core proceedings under § 157. *See* § 157(b)(2)(H). The Defendants in other
13 cases argued that withdrawal of the reference is appropriate because the estate's
14 claims of fraudulent conveyance are, like the counterclaim in *Stern*, subject to the
15 jurisdiction of Article III courts and may not be conclusively resolved by a
16 bankruptcy court. The Defendants found support for this proposition in *Stern* itself
17 where the Court, recounting its earlier decision in *Granfinanciera, S.A. v.*
18 *Nordberg*, 492 U.S. 33 (1989), characterized fraudulent conveyance actions as
19 “quintessentially suits at common law.” *Id.* at 2614 (quoting *Granfinanciera*,
20 492 U.S. at 56). As such, the Defendants argued, the bankruptcy court is not

1 empowered to enter final judgment on these claims and they are best resolved in
2 the district court.

3 The trustee suggests that even if a fraudulent conveyance action is the type
4 of action in which the bankruptcy court cannot enter final judgment, the
5 bankruptcy court can address the fraudulent conveyance actions by handling them
6 in the same manner as it addresses non-core proceedings, i.e., by issuing proposed
7 findings of fact and conclusions of law instead of a final judgment. Any final
8 judgment would then be issued by this Court and would unquestionably meet
9 constitutional muster.

10 Some have argued that a bankruptcy court is not authorized to resolve core
11 proceedings through a process of issuing proposed findings of fact and conclusions
12 of law.¹ They assert that while § 157(b) authorizes a bankruptcy court to enter
13 “appropriate orders and judgments” with regard to core matters, there is no
14 statutory authorization for the bankruptcy court to issue proposed findings of fact

15 ¹The Court notes that the Ninth Circuit, in a case that is currently pending,
16 has invited supplemental briefing on both the question of whether bankruptcy
17 courts may enter final judgment on fraudulent conveyance actions and whether
18 bankruptcy courts are authorized to submit proposed findings of fact and
19 conclusions of law in core proceedings. *In re Bellingham Ins. Agency, Inc.*, 661
20 F.3d 476 (9th Cir. 2011).

1 and conclusions of law. *See* § 157(b)(1). Instead, authority to issue proposed
2 findings and conclusions is limited to non-core matters. *See* § 157(c)(1).

3 This argument has been widely rejected. *See e.g. RES-GA Four LLC v.*
4 *Avalon Builders of GA, LLC*, 10-CV-463, 2012 WL 13544, at *9-*10 (M.D. Ga.
5 January 4, 2012) (Collecting district court and bankruptcy court decisions holding
6 that a bankruptcy court may issue proposed findings of fact and conclusions of law
7 in core proceedings). Where the Supreme Court has struck down a portion of a
8 statute as unconstitutional, a district court's duty in construing the remainder of the
9 statute is to "determine what 'Congress would have intended' in light of the
10 Court's constitutional holding." *United States v. Booker*, 543 U.S. 220, 246 (2005)
11 (citing *Denver Area Ed. Telecomm. Consortium, Inc. v. FCC*, 518 U.S. 727, 767
12 (1996)). Congress intended for bankruptcy courts to be able to adjudicate actions
13 relating to title 11. *In re The Mortgage Store, Inc.*, 464 B.R. 421, 427 (D. Haw.
14 2011). As such, Congress's intent is best served by allowing core proceedings to
15 be addressed through proposed findings of fact and conclusions of law where there
16 are questions as to the bankruptcy court's constitutional authority to enter final
17 judgment in the proceeding.

18 Having concluded that the bankruptcy court may still hear core proceedings
19 as long as any final judgment resolving that proceeding is ultimately entered by the
20 district court, the Court must determine whether withdrawal of reference is

1 appropriate in this case. A review of the relevant factors set out in *Sec. Farms*, 124
2 F.3d at 1008, leads the Court to conclude that the pretrial process, including
3 dispositive pretrial motion practice, is best handled by the bankruptcy court.
4 Specifically, uniformity of bankruptcy administration, the avoidance of delay, and
5 the efficient use of judicial resources support the handling of pretrial process in the
6 bankruptcy court given what promises to be a document-intensive motion practice
7 and the bankruptcy court's expertise in avoidance actions and existing knowledge
8 of the record. However, the Court concludes that judicial economy favors holding
9 trial in the district court as trial already necessitates a comprehensive presentation
10 of evidence and holding trial in the district court will avoid the need for any form
11 of de novo review.

12 Accordingly, **IT IS HEREBY ORDERED:**

13 1. The Trustee's Motion to Withdraw Reference, **ECF No. 1**, is

14 **GRANTED IN PART AND DENIED IN PART.**

15 2. The Court **WITHDRAWS THE REFERENCE** in the above-captioned
16 case with regard to all defendants and with regard to all causes of action.

17 3. All unresolved substantive or evidentiary issues that may foreseeably
18 arise during trial shall be addressed by motions *in limine* to be filed and
19 served on or before **March 8, 2013**. Responses shall be filed and served
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1 on or before **March 15, 2013**. Such motions will be addressed and
2 resolved at the pretrial conference.

- 3 4. A joint Pretrial Order, prepared in accordance with the format provided
4 in Local Rule 16.1(b) shall be filed in the district court on or before
5 **March 28, 2013**, and a copy e-mailed to the Court at
6 peterasonorders@waed.uscourts.gov. Plaintiff's trial exhibits are to be
7 numbered 1 through 199; defendant's exhibits 200 and following. In
8 preparing the joint Pretrial Order, the parties shall confer regarding
9 duplicate exhibits and determine which party will submit such exhibits
10 for trial.
- 11 5. Trial briefs and requested voir dire shall be filed in the district court and
12 served on or before **March 28, 2013**.
- 13 6. Prior to **March 28, 2013**, the parties shall confer regarding jury
14 instructions. On or before **March 28, 2013**, the parties shall jointly file
15 in the district court a complete set of jury instructions that contain copies
16 of each instruction on which the parties agree and copies of each
17 instruction that is disputed (i.e., a copy of each party's proposed version,
18 if any, of an instruction on which they do not agree). All instructions
19 shall be short, concise, understandable, and neutral statements of the law.
20 Argumentative instructions shall not be submitted or given. To be

1 complete, the joint set of instructions must include instructions
2 addressing the elements of each claim or defense, and a proposed verdict
3 form. Instructions need not be submitted on issues that are not unique to
4 this case, such as standard opening and closing instructions. Two copies
5 of each proposed instruction, one cited and one un-cited, shall be filed
6 and a copy e-mailed to the court at *peterasonorders@waed.uscourts.gov*.
7 *See also* Local Rule 51.1.

- 8 7. On or before **March 28, 2013**, each party shall file in the district court
9 and serve a legal memorandum addressing any objections the party has
10 regarding any instructions proposed by any other party. In their
11 memoranda, the parties shall identify the specific portion of any proposed
12 instruction to which they object and shall concisely state the basis for the
13 objection. If any of the proposed instructions are modified versions of
14 model instructions, the parties shall identify the modification and legal
15 authority for the modification. Objections asserting that an instruction
16 sets forth an incorrect or inappropriate statement of law shall cite specific
17 legal authority supporting the objection. Failure to file an objection and
18 supporting memorandum may be construed as consent to the adoption of
19 an instruction proposed by another party. Any objection or proposed
20 instruction for which a good faith basis does not exist may result in

1 sanctions. The party proposing a disputed instruction may file a
2 memorandum responding to any other party's objections, but must do so
3 on or before **March 28, 2013**.

4 8. An in-person pretrial conference will be held on **April 9, 2013**, at **9:00**
5 **a.m.** in district court in **Spokane**, Washington.

6 9. The **jury** trial shall commence on **April 22, 2013**, at **9:00 a.m.** in district
7 court in **Spokane**, Washington

8 10. Pursuant to Rule 16 of the Federal Rules of Civil Procedure, this
9 schedule "shall not be modified except upon a showing of good cause
10 and by leave [of the Court]." Rule 16(f) of the Federal Rules of Civil
11 Procedure provides for sanctions for failure to obey the Scheduling
12 Order.

13 11. The Court **REFERS** the above captioned matter back to the bankruptcy
14 court for that court to address all matters prior to trial, including
15 discovery and dispositive motions and any scheduling orders as are
16 necessary to address pretrial motions. With regard to dispositive
17 motions, the bankruptcy court shall file proposed findings of fact and
18 conclusions of law. This Court will review de novo those matters to
19 which any party has timely and specifically objected. Any final
20 judgment entered pursuant to resolution of a dispositive motion will be

1 entered by this court only after considering the bankruptcy court's
2 proposed findings of fact and conclusions of law. The one exception is
3 that motions for default and default judgment may be raised in the first
4 instance in this Court.

5 **IT IS SO ORDERED.**

6 The District Court Executive is hereby directed to enter this Order and to
7 provide copies to counsel.

8 **DATED** this 11th day of October 2012.

9
10 *s/ Rosanna Malouf Peterson*
11 ROSANNA MALOUF PETERSON
12 Chief United States District Court Judge
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